

Purpose of the research

The aim of this study is to objectively and independently estimate the size of the illicit tobacco market and capture the main determinants of tax evasion activities in the SEE region.

POLICY RECOMMENDATIONS

1. Countries should strengthen institutional capacities to tackle the illicit tobacco market

Strengthening their capacities will not only increase fiscal revenues from tobacco, but would also ensure that tax increases serve their intended purpose of reducing smoking prevalence.

Since the possibility of purchasing illicit packs in legal places of purchase increases MC evasion, **countries should particularly focus on enforcing bans on the sale of illicit MC in legal shops.**

2. Improve regional cooperation in fighting illicit trade

As residents of municipalities in close proximity to countries with high MC evasion are more likely to evade taxes on MC themselves, improving regional coordination in the development and implementation of tobacco control policies, including prevention of the illicit market, is essential to lowering tobacco tax evasion in all SEE countries.

3. All SEE countries should ratify and implement the FCTC Protocol to Eliminate Illicit Trade

Albania, Bosnia and Herzegovina, and Kosovo should become Parties to the Protocol. Although North Macedonia has already signed the Protocol, it still needs to become a Party, whereas Serbia and Montenegro, as official Parties, need to invest more in efforts towards its strict implementation.

4. All SEE countries should regulate and enforce excise tax stamp requirements on the HR tobacco market to a much higher degree

Currently HR tobacco is predominantly illicit throughout the region. As the predominant place of purchase for HR tobacco is on the street or in open air/green markets, the governments should invest more efforts in **preventing unlicensed individuals selling HR tobacco products in these places and detecting the sources of illicit HR tobacco products.**

Tobacco tax avoidance and evasion are of high policy relevance

The current prevalence of adult tobacco smoking in the Southeastern Europe (SEE) region is very high at 37.6 percent ([IEN, 2020](#)). Tobacco taxation is an essential tool for reducing tobacco use, saving lives, and increasing government revenues.

Tobacco tax evasion undermines the primary goal of tobacco taxation: making tobacco products less affordable; while at the same time decreasing government revenues and increasing health risks for smokers, since illicit cigarette packs usually do not present important information about the harmful effects of tobacco use.

5. Implement measures that would stimulate farmers to replace production of tobacco with other plants

In line with FCTC Protocol to Eliminate Illicit Trade in Tobacco, adoption of new measures to tackle illicit HR tobacco should also deal with other actors in the supply chain (growers, manufacturers, exporters/importers, and wholesalers).

In countries where HR tobacco is produced, it is necessary to **implement measures that would stimulate farmers to replace production of tobacco with other plants.**

Methodology

The study is based on the unique data set from the Survey on Tobacco Consumption in Southeastern Europe ([STC-SEE](#)).

In this research, a pack is illicit if it has at least one of the following four characteristics ([Joossens et al., 2010](#)): 1) purchased from an illicit source, 2) without the appropriate health warnings, 3) without the appropriate tax stamp, or 4) purchased at a price lower than 70 percent of the lowest price. Tax avoidance is defined as a pack purchased from authorized sellers, but at a discounted price.

More details on the methodology are available in the research report at tobaccotaxation.com.



MAIN RESEARCH FINDINGS

1. About one fifth of the tobacco market in the SEE region is illicit

One in five smokers (20.4 percent) in the SEE region smokes illicit cigarettes, while the overall size of the illicit tobacco market is 19.7 percent of total consumption.

The share of illicit consumption in the hand-rolled (HR) tobacco market is much higher than that for manufactured cigarettes (MC) (88.5 percent versus 8.1 percent respectively). Since most current smokers in the region use MC rather than HR tobacco (32.8 percent and 6.3 percent prevalence, respectively), the overall rate for these two types of products is closer to the share estimated for MC.

2. HR is predominantly illicit in all six countries, while MC evasion differs significantly across the region

The MC evasion is the highest in Montenegro (57.7 percent), where it is about three times as high as the country with the next highest share, Bosnia and Herzegovina (18.1 percent). In the other SEE countries the MC evasion rate is below 4 percent (Figure 1). Tax avoidance is very rare, with less than one percent of tobacco users avoiding taxes in all countries.

3. Preventing sale of illicit products at legal points of sale lowers MC tax evasion

The research suggests that statistical regions with higher share of illicit purchases at legal points of sale (in total illicit purchases) have more MC tax evasion.

4. Proximity to countries with high MC evasion increases the likelihood of MC evasion

Smokers living in municipalities near countries that have high MC evasion rates have a higher likelihood of MC tax evasion. This indicates a certain spillover effect, as physical proximity to an area with a high level of tax evasion increases the likelihood of evasion.

5. Illicit HR is almost completely sold on the streets or in open air or green markets

Out of all illicit HR purchases 92 percent is sold on the streets or open air/green markets. Share of illicit purchases at legal point of sale and proximity to countries with higher evasion do not impact HR evasion.

6. Evasion is determined by income, gender and age

Smokers from low-income households, women, and the elderly tend to evade taxes more often. This conclusion applies to both HR tobacco and MC evasion.

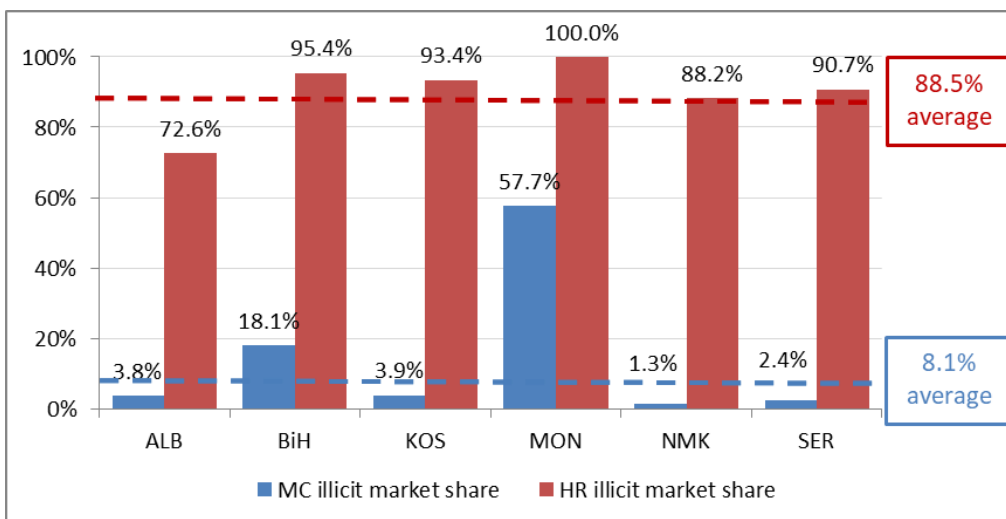


Figure 1. Share of illicit MC and HR market in the SEE region

Note: The share of illicit market (MC or HR) is defined as the ratio between the number of illicit cigarettes smoked (average number of illicit cigarettes smoked multiplied by the number of smokers who evade) and the total number of cigarettes smoked (average number of total cigarettes smoked multiplied by total number of smokers).

About the project

The Institute of Economic Sciences from Belgrade, Serbia is coordinating a regional network of researchers in Southeastern Europe on tobacco taxation. The project is funded by the University of Illinois at Chicago's (UIC) Institute for Health Research and Policy to conduct economic research on tobacco taxation in Serbia. UIC is a partner of the Bloomberg Initiative to Reduce Tobacco Use. The views expressed in this document cannot be attributed to, nor do they represent, the views of UIC, the Institute for Health Research and Policy, or Bloomberg Philanthropies.

